
The Principles of International Trade Contract as Reference of Indonesian Contract Law

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Abstract:

There is no legislation to regulate international contract commercial in Indonesia. The law that has been regulating such activity still refers to the Indonesian Civil Code (book III) which it's an inheritance of the Dutch colonial government (the Dutch 1838 Civil Code).

Many people said that the law is out of date and it will be a problem and an obstacle to perform international commercial contract in Indonesia (especially contract that involve foreign entities). In accordance with that, there is an opinion that it is urgent for Indonesia to make a new legislation as soon as possible to replace or reform the old code. Even though on the other side, people said that an old code (book III Civil Code) is still appropriate to regulate performing contracts including international commercial contracts in Indonesia.

The research resume that to modernize the Indonesian contract law, it is better to refer to the international contract profiles and rules. The UNIDROIT principles on international commercial contract are maybe the best source for modern Civil Code (Book III) and UNIDROIT Principles have fundamental principles value like "Freedom of Contract, Consensualism", and so on.

It means that some fundamental values in the UNIDROIT Principles are not strange to Indonesian law.

Keywords: *Contract, Indonesian Civil Code , UNIDROIT.*

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1. Introduction

The parties of international contract face difficulties in determining the rights and obligations when they are in different countries. The illustration in this article is an Indonesian steel company named Krakatau bargaining slab steel with a factory in Uruguay made through sales agents in Indonesia who got orders from agents in Thailand. After a change of order confirmation a drastic market price decline occurred and the Krakatau had to negotiate. a question arises if the company could cancel the order. To answer it, a Indonesian lawyer start searching for the legal source on Book III of the Indonesian Civil Code. The solution of the problem was difficult if it was not based on the theory of contract, when the agreement binds the parties, and when it is not known what is the most essential element of the agreement. In addition, the judgment was poor with jurisprudence, which can be used as a guide and as a collection of arbitration decisions in Indonesia. Practitioners conducting negotiations or drafting commercial contracts should learn and understand the principles of international commercial contracts of UNIDROIT (The International Institute for International Contract), as one of the works that seek to standardize the principles of contract law. The problem becomes even worse when the applicable law in a country is a legal product that has been out of date or not accommodate the existing developments.

It is recognized that economic globalization promotes the harmonization of international commercial law, as business people between different countries will meet each other so the same legal principles are required. The influence of foreign law on the practice of contractual relationships in various countries, including Indonesia, is inevitable. The enactment of the WTO (World Trade Organization), APEC (Asia Pacific Economic Cooperation), and AFTA (Asian Free Trade Area) will encourage the intensity of civic relationships in the form of various commercial contracts.

Contract law is an important issue in the globalization era especially to support activities in the trade sector and international business transactions. Bringing together the relation of the parties within the international sphere is not a simple theme.

2. Literature Review

The notion of a contract is an agreement known, oral or/and written, which is related to social business or trade. Simpson (1965) defines a contract as an agreement between two or more persons consisting of a promise or mutual promises which the law will enforce, or the performance of which the law in some way recognizes as a duty.² Black laws Dictionary made the interpretation of a contract as “*An agreement*

²Laurence P. Simpson,, *Contracts*, 2nd edition, West Publishing Co, St Paul, Minnesota, 1965.

between two or more persons which creates an obligation to do or not to do a particular thing". Subekti (2010) an Indonesian lawyer defined contract as the agreement for an event in which there is a promise to another person or two people promise each other to do or not to do something.³

The development of contractual law in International trade is not released from human development with its trade activity thus the development of international trade cannot be separated from the development of contract law (Shmaliy and Dushakova, 2017; Serebryakova *et al.*, 2016). Atiyah (1984) stated that development of contract law divided on four phases⁴. First, international law embodied in *lex mercatoria*, second, international contract law in national law, third international contract law as a standard contract, fourth, international contract law in cyberspace.

Contracts in Indonesia are governed by either (i) *Adat* (customary) Law or (ii) the Indonesian Civil Code. Generally *Adat* Law governs contracts between members of the indigenous population in a rural area. It does not designed for European or international transactions.

Adat Law is not written, not statutory, and not uniform throughout Indonesia. *Adat* evolved out of the needs of closed village community. Under *Adat* Law, the requirement of a contract is the real agreement i.e. one which is actually performed.

- a. There is no definite age limit for one to have the ability to enter into a contract as married women also have.
- b. Contracts involving non-concrete objects are exceptional but possible.
- c. Like the Civil Code, *Adat* Law requires free will of the contracting parties and legal *cause* of the contract.

Indonesian Civil Code (Kitab Undang Undang Hukum Perdata or another name is *Burgelijke Wetboek*) on Book III covers, in general, all terms of agreement consisting from four chapter and has two hundred twenty four articles starting from 1238 to 1864. *Burgelijke Wetboek* (BW) was started in 1839 by a commission consisting of Scholten van Our Harleem, Scheiner and Van Nus, which is also a copy of the French Civil Code (1804). While the French Civil Code itself comes from Roman law, French customary law, ordonance and intermediare law or law established since the beginning of the French revolution in 1789. Thus Book III of the Civil Code (BW) is rooted in the ancient law, which is now more than two centuries since its enactment on 1 May 1848 and based on the principle of concordance in force in the Indies. Although Indonesia had to declare the Independence on 17 August 1945, some Dutch legislature still used until now with the basic of transitional provision the 1945 Constitution.

³R. Subekti, *Hukum Perjanjian*, Jakarta, Intermasa, 2010, hal. 20.

⁴P.S. Atiyah, *An Introduction to the Law of Contract*, Oxford, Clarendon Press, 1984, page 65.

The Netherlands as a country that brings *Burgelijke Wetboek* (Indonesian Civil Code) has replaced it with *Nieuw Burgelijke Wetboek*. This codification has been much more advanced both in terms of substance and systematic form as the correction contain as *Burgelijke Wetboek*. The New Dutch Civil Code consist of three thousand articles and eight books covering as follows:

Book 1: Individuals and Family; Book 2: Legal Entities; Book 3: Property and Assets; Book 4: Inheritance /Succession; Book 5: Law of Obligations; Book 6: Contracts, Definitions; Book 7: Specific Contracts 1; Book 7(a) Specific Contracts 2; Book 8: Movement Resources and Transport; Book 9: Intellectual Property; Book 10: Private International Law.

3. Structure of the Indonesian Civil Code

Book I, concerning family, matrimony, and inheritance. The section on matrimony is no longer applicable as it has been replaced by Law No. 1 Year 1974. The section on family and inheritance applies only to non-Muslim citizen.

Book II, concerning assets, lien, and mortgages. The section on mortgage is no longer applicable as of the enactment of Law No. 42 in Year 1996.

Book III, concerning contracts which applies facultatively, means that contracting parties may waive it.

Book IV, concerning evidence, which is still applicable especially as procedural law.

In Indonesian Civil Code there are four basic essentials to the creation of a contract. Accordingly Article 1320 states that a contract is valid only if it fulfills the following requirements:

a. Concluded based on the free will of the parties; b. Competent parties; c. Definite object; and d. Legal object and matters.

In common law, there are three basic essentials to the creation of a contract:

a. agreement; b. contractual intention; c. consideration.

The first requirement of a contract is that the parties should have reached an agreement. Generally speaking, an agreement is reached when one party makes an offer, which is accepted by another party. In deciding whether the parties have reached agreement, the courts will apply on an objective test. According to Singapore legal system essential elements for a contract are:⁵

⁵*Suchittra Vasu, Contact Law For Business people, 2nd Edition, Rank Book, Singapore, 2001, page 18.*

- a. Offer: The concept of of contractual is basically that a party puts a proposition forward, which could be made open either to the world at large or to an individual;
- b. Acceptance: It can be made either verbally, in writing or by other modes of communication such a telex, faximile, transmission or by other electronic means;
- c. Intention to create legal relations: Parties must be bound in the agreement, which is legal enforceable;
- d. Considerations: It has to be something of value in the eyes of law, normally in monetary terms but not always so long as it is of some value.

4. Principles and clauses in Indonesian Contract law

There are some principles and clauses in Indonesian Civil Code that must be applied in contract in order to avoid harm elements. They are the following:

1. Freedom of contract: In Indonesia civil code was hold in article 1338; it states that parties or Indonesian people could make some kind of contract not in conflict with any law, custom, religion, propriety and decency such as joint venture, franchise, MOU (Memorandum of Understanding), leasing. This agreement is an innominat contract. Nominat contract is an agreement on Indonesian Civil Code (Burgelijke Wetboek) and two kinds of contract were arranged by Article 1229.

The following are types of contracts which are regulated separately in the Indonesian Civil Code:

1. Sale and purchase agreement;
 2. Exchange agreement (Article 1541 - 1546);
 3. Lease agreement (Article 1548 – 1600);
 4. Agreement to do the work (Article 1601 -1617);
 5. Maatschap (Article 1618 -1652);
 6. Association (Article 1653 -1665);
 7. Grant agreement (Article 1666 – 1693);
 8. Goods custody agreement (Article 1694 – 1743);
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2. Consensual principle: This principle was held on Article 1320 (1) noted that contract in general can be held formally but sufficient with the agreement of both parties.
 3. Pacta Sunt Servada: This principle means that a judge or third party must respect the substance of the contract which made the parties as the law.
 4. Good faith: This principle is contained in Article 1338 paragraph 3 which states that the agreement must be in good faith.
 5. Personality: Personality is a principle which determines that a person will commit to make a contract for himself.

This research would like to see the development of international commercial law principles that could be useful for renewal of contract law in Indonesia. As an example of Ferronica Taylor in his book *“Indonesia Law and Society”* with subtitles *“The Transformations of Indonesian Commercial Contracts and Legal Advises”*, among others stated:

“The legal rules that govern contracts in Indonesia are found primarily Dutch-style Civil Code and partially revised Commercial Code, although many of the Code provisions are now regarded as absolute or inappropriate for current commercial transaction. Commercial parties routinely seek to contract out or exclude the operation of archaic parts of the Code from their own contracts. The fact that there is no authorized or standardized translation of the Civil Code into English also symbolizes its lack of pungency”.

Ferronica Taylor recommends that Indonesia's future contract law is subject to UNIDROIT's contractual legal principles (The United Nations International Trade Law). Some of the common problems faced include positive law (Indonesian Civil Code) based on the principle of freedom of contract which is a legacy of Napoleon is in some ways already behind, because the Dutch country itself *Burgelijke Wetboek* which has long been changed and replaced with *Nieuwe Burgelijke Wetboek* whose content has been adapted to the principles of UNIDROIT.⁶

Even the principles of UNIDROIT have been adopted into the principle of commercial contract law of the European Community in 1996 and the current Civil Code prevailing in Indonesia today comes from Roman law collected in a collection of manuscripts called *Corpus Iuris Civilis* which originally was only a collection of customary practices in Roman society and Southern France since 450 BCE, from simple to complex societies. The manuscript was later compiled into a legal book known as the Code Napoleon, then adopted by the Dutch in 1838 and ten years later (1848) valid in Indonesia.

As a legal concept, the contractual paradigm based on classical theory shows several characteristics⁷, such as:

- a. Generally, contract is based on an exchange of promises. This character basically gives bilateral nature to a contract, which means that contracts are formed due to the mutual promises by the parties.
- b. Contract is executor, it means they are formed the rights and obligations published before the parties implement these obligations.

⁶Ferronica Taylor, *The Transformation of Indonesian Commercial Contracts and legal Advises, Dalam Indonesia, Law and Society*, Sydney, The Federation Press, editor: Timothy Lindsey, 199, pp 279.

⁷Academic Paper *Indonesian Contract Law*, BPHN, July, Jakarta, 2012.

- c. Based on common law tradition a simple contract involves the exchange of achievement among the parties. On civil law tradition, it is possible only if one of the parties makes a pledge to give an achievement along as the other party agree.
- d. The contents of the contractual obligations of the parties may be determined by what is agreed upon by the parties.
- e. Transactions that are written into contract aren't part of a sustainable relationship.
- f. The role of the judiciary mostly acts as they are referees who will enforce the parties agreement and has little role to determine whether the parties' transactions are fair or not.
- g. The above characteristics are generally placed on the assumption that the parties have an equal bargaining position.

In a civil law tradition a contract could emerge from a legal act which is a manifestation of the will of one party only (*unilateral juridical act*) or legal acts which are implemented on the exchange of wills expressed and agreed by the parties and make a *bilateral juridical act*.

On New Dutch Civil Code (*Het Nieuwe Burgelijke Wetboek*, NBW), a contract is essentially regarded as a multilateral act and does not include unilateral legal act or unilateral contracts.

The definition of contract on Book Sixth Title 1 New Dutch Civil Code⁸ is a similar agreement within the meaning of this title in a multilateral legal act whereby one or more parties engage in a commitment to one or more other parties

Indonesian Civil Code, Article 1313 is a legal act which one or more persons commit themselves to one or more persons. In the common law tradition, a unilateral and bilateral concept begins from the contract as the manifestation of one will (unilateral) or two wills (bilateral)⁹. When the contract formation begins with an offer or promises to do something or not, if the other party is willing to do something or not, while the other is not to make any promises (option contract), then the contract is unilateral. Bilateral contracts are if an offeror and offeree parties bind themselves to do something or not to do to the other parties on a reciprocal basis.

5. Hypothesis Development

⁸Article 213 (art.6.5.1.1) article (1): A contract in the sense of this title is a multilateral Juridical act whereby one or more parties assume an obligation towards ne or more other parties.

⁹Alain Levasseur, *Comparative Law of Contracts_Cases and Materials*, Carolina Academic Press, North Carolina, 2008, p. 13.

Based on the above the research hypotheses set in this article are the following:

- a. Are the provisions of the contract law as contained in Book III of the Indonesian civil Code which is a Dutch heritage still efficient to regulate international trade transactions in the present situation of globalization?
- b. These countries in renewing their contract law are subject to many international customary law or laws of international organizations, such as UNIDROIT (The International Institute for Unification of International Private Law) where its legal principles may also apply to civil law reforms in Indonesia.

6. Results and Discussion

International business contract activities should be exercised by the parties based on the agreements set forth in an international contract. Gautama (1976) defined international contract as national contract with foreign elements. Theoretically, the foreign elements in a national contracts are the following:¹⁰

- a. Different nations;
- b. The parties have legal domicile in different countries;
- c. The law chosen is foreign law;
- d. The contract refers to overseas;
- e. Contract dispute solution refers to overseas;
- f. The contract is signed overseas;
- g. The object of the contract is overseas;
- h. The language used in the contract is a foreign language;
- i. The use of foreign currency in the contract.

The difference of citizenship leads to the consequence that in an International contract there maybe are two different legal system so that the field of International contract is not easy. There are actually two fundamental principles in international contract:

- a. The supremacy of national law;
- b. The party's autonomy.

As outlined in the previous section to reform Indonesian contract law is both demanded and required to support the implementation of international trade and business transaction. One of the most salient problems of law making in a global world is how to deal with diverging national legal cultures. Ever since the emergence of the nation-state, law making has primarily been a task for the national

¹⁰Sudargo Gautama , *Kontrak dagang Internasional, Bandung, Alumni, 1976.*

legislatures and courts¹¹. They "make" law for relatively homogeneous societies that are usually characterized by a common language and culture. This law can be enforced by the State. As a result of increasing globalization, this classic picture is now rapidly changing. If the law is to retain its role of regulating the society (it is no longer national, but a global one), we have to find new ways of making law and enforcing this law. In doing so, several fundamental questions have to be answered. One is whether law makers should really aim for one uniform (private) law-as in the nation-state--or rather allow diversity of jurisdictions. Another is, even if there is a need to harmonize the law, whether this uniformity is possible in view. In this case harmonization of law is a demand as well as a need that must be met by the parties in the implementation of trade or international business transactions. Honka (2008) said that harmonization law could be done through several ways, namely:¹²

1. National legislation in the area of contract law;
2. Use of standard contracts;
3. Implementation of international customs;
4. International legal principles;
5. Arbitration jurisprudence;
6. Legal guide/guidelines and legal doctrine.

In addition to make completely , Roy Goode stated that harmonization of law could be done through:

1. A multilateral convention without a uniform law;
2. A multilateral convention embodying a uniform law;
3. A set of bilateral treaties;
4. Community legislation, typically, a directive;
5. A model law;
6. A codification of custom and usage promulgated by an international non – governmental organization;
7. International trade terms promulgated by such an organization;
8. Model contracts and general contractual condition;
9. Restatement by scholar and experts.¹³

Efforts to harmonize the contract law in an international context are effectively carried out by international, publicly-funded institutions or organizations such as the United Nations Commission on International Trade Law (UNCITRAL) or independent international organizations such as the International Institute for the

¹¹Jan M. Smits, *Louisiana Law Review: Law making in The European Union on Globalization and Contract Law*, 67, 1182-2007, Louisiana, USA.

¹²Huala Adolf, *Dasar –dasar Hukum Kontrak Internasional*, Bandung, Refika Aditama, cet 2, 2008.

¹³Roy Goode, *Transnational Commercial Law*, 2015, Oxford University Press, United Kingdom, page 143.

Unification of Private Law or the International Pour L'unification Du Droit Prive Institute commonly known as UNIDROIT.

UNIDROIT has published UNIDROIT Principles of International Commercial Contracts (UPICCs) in 1994. In the annual meeting held 19-21 April 2004, the Governing Council of UNIDROIT set the new edition of the UNIDROIT Principles of International Commercial Contracts 2004. UPICCs (UNIDROIT Principles of International Commercial Contracts) apply to the parties universally who agree. The enactment of UPICCs as a source of contract law is stated in the preamble of the document. They shall be applied when the parties have agreed that their contract be governed by them. Parties wishing to provide that their agreement be governed by the Principles might use the following words, adding any desired exceptions or modifications: *"This contract shall be governed by the UNIDROIT Principles (2004) [except as to Articles ...]"*. Parties wishing to provide in addition for the application of the law of a particular jurisdiction might use the following words: *"This contract shall be governed by the UNIDROIT Principles (2004) [except as to Articles...], supplemented when necessary by the law of [jurisdiction X]"*.

- a. *They may be applied when the parties have agreed that their contract be governed by general principles of law, the lex mercatoria or the like.*
- b. *They may be applied when the parties have not chosen any law to govern their contract.*
- c. *They may be used to interpret or supplement international uniform law instruments.*
- d. *They may be used to interpret or supplement domestic law.*
- e. *They may serve as a model for national and international legislators.*

Under these term UPICCs have a very big jurisdiction. The parties who sign the UPICCS could use the provision without need for ratification. UPICCs can be used as a source of law for the parties who do not choose any law as the contract arrangement. Furthermore, UPPICs as a model law can be used as a reference for legislators in the formation of national law.

Since January 1st 2009, Indonesia has been of UNIDROIT member which all members reached 63 countries.¹⁴ The membership of Indonesia as a member of UNIDROIT was marked by endorsement with the presidential regulation number 59 of 2008 about *International Institute for The Unification of Private Law (UNIDROIT)* which enacted 2 September 2008. The important principles of contract law contained in UPICCs that can be used as a consideration in renewal of contract law in Indonesia are as follows:

1. *The Principle of freedom of contract:*

¹⁴Indonesia-UNIDROIT Member State,

<<http://www.unidroit.org/english/members/accession/indonesia.htm>> [20-06-2009]

This principle on UPICCs regulated in more detail, applicable, flexibility than the settings contained in Indonesian Civil Code. These principles are:

- a. Freedom to determine the content of the contract;
- b. Freedom of formation of contract;
- c. Contract are binding as a law for the parties;
- d. Mandatory rules as an exception;
- e. The international model and purpose of UPICCs to be considered in the interpretation of the contract.

2. Consensual and real principles as the basis for binding contracts:

These are two principles that become the starting point of the binding of an agreement that is consensual principle in Indonesian Civil Code and real principle in Adat (custom) law. The difference in the application of this principles will affect to the pre contractual liability. Indonesian civil code does not pay any attention to the process of the occurrence of the contract whereas in practice can start when preceded by an agreement and its obtained through with negotiation, but good faith. Actually on negotiation process has arisen the rights and obligations of the parties to uphold good faith and fair dealing.

In business world, contract starts with negotiation where the parties submits letter of intent. Then after there is an agreement on the willingness make the contract then the parties will create a memorandum of understanding contained of the all wishes. This process named pre contract. Indonesian Civil Code don't have this principles : letter of intent , memorandum of understanding or pre contract. In UPICCs is known for the principle of prohibition of negotiating in bad faith, as stated in Article 2.1.15:

1. A party is free to negotiate and is not liable for failure to reach an agreement;
2. However, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party;
3. It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party.

3. The definition of contract:

Indonesian Civil Code means contract or agreement in the same sense, as described in Article 1313 where this definition has many shortcomings. These are:

- a. Only concerning one –side agreement;
- b. The word deed is too broad because it is a deed without understanding the acts against the law;
- c. Understanding too broad including marriage agreement;
- d. Without mentioning its purpose.

The Netherlands has revised the notion of contract in Nieuw Burgerlijk Wetboek (Dutch Civil Code) as stated: “*A contract in the sense of this title is a multilateral juridical act whereby one or more parties assume an obligation towards one or more other parties*”. The definition of contract in Dutch Civil Code has followed the terms of the contract in the UPICCs, should Indonesian Civil Code also adjust the definition is.

4. *Gross Disparity:*

Gross disparity is an unbalanced situation that causes a hinkend contract in Indonesian Civil Code. In Indonesian Civil Code, limp contract is limited if the parties are not competent or under age. UPPICs set more fully and applicable as contained in Article 3.10 stated:

1. A party may avoid the contract or an individual terms of it if, at the time of the conclusions o the contract, the contract otr term unjustifiably gave the other party an excessive advantage. Regard is to be had among factors as:
 - a. The fact that the other party has taken unfair advantage of the first party’s dependence, economic distress or urgent needs, or of its improvidence, ignorance , inexperience or lack of bargaining skill;
 - b. The nature and purpose of the contract.
2. Upon the request of the party entitled to avoidance, a court may adapt the contract or term in order to make it avccord with reasonable commercial standard of fair dealing.
3. A court may also adapt the contract or term upon the request of the party receiving notice of avoidance , provided that that party informs the other part of its request promptly after receiving such notice and before the other party has reasonably acted in reliance on it.

5. *Standard contract:*

Indonesian civil code did not govern a standard contract while in national or international scope these contracts are commonly used.

6. *Hardship:*

Indonesian civil code does not regulate if the contract is not implemented due to changes in fundamental conditions , such as economic crisis that occurred Indonesia several years ago caused many contracts can not be completed.

7. **Conclusion**

- a. UNIDROIT principles can be used in a variety of different contexts, so these principles are not only used in the drafting of a new law (legislation) but can also be used in the practices of international trade contracts.
- b. UNIDROIT principles are easily accessible, as these principles have been published in various languages.

- c. Legal practitioners as well as legal consultants and scientists in Indonesia may use, elaborate, develop these principles in order to protect the interests of business practitioners of both producers and consumers in international contract in this new era.

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